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No. 06-43

IN THE
# Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,

*Petitioner,*

v.

SCIENTIFIC-ATLANTA, INC. AND MOTOROLA, INC.,

*Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

## BRIEF FOR RICHARD I. BEATTIE, KENNETH J. BIALKIN, ARTHUR FLEISCHER, JR., JOSEPH H. FLOM, IRA M. MILLSTEIN, JACK H. NUSBAUM AND E. NORMAN VEASEY AS AMICI CURIAE SUPPORTING RESPONDENTS

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## INTEREST OF AMICI CURIAE[1]

Amici Richard I. Beattie, Kenneth J. Bialkin, Arthur Fleischer, Jr., Joseph H. Flom, Ira M. Millstein, Jack H. Nusbaum and E. Norman Veasey are experienced transactional lawyers from a variety of prominent law firms.[2] Amici regularly represent financing counterparties to issuers, including underwriters, private equity firms and large financial institutions, in a wide range of financial transactions, including public and private offerings, structured finance, commodities and derivatives transactions, off-balance sheet financings, joint ventures, limited partnerships, mergers and acquisitions.

In connection with such transactions, amici often advise their clients in multiple ways, including negotiating, drafting and reviewing legal documents, assisting clients in their due diligence investigations and providing opinion letters. For years, amici have been providing legal advice to clients participating in complex structured finance and other financial transactions with public companies. That legal advice has, of course, derived from, *inter alia*, this Court's precedents regarding liability under Section 10(b) of the Securities Exchange Act of 1934 for actors who mislead the

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[1] Letters reflecting petitioner's blanket consent to the filing of amicus briefs and respondents' consent to the filing of this brief have been lodged with the Clerk of Court. No counsel for any party authored this brief in whole or in part, and no person or entity other than amici and their counsel has made a monetary contribution to the preparation or submission of this brief. Counsel of record for amici is also counsel of record for certain respondents in *Regents of the University of California v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 06-1341 (petition for cert. filed Apr. 5, 2007), which presents legal issues similar to those involved in this case.

[2] A list of amici, along with the law firms of which they are members, is included in an appendix hereto.

securities markets, and the bright-line rule for secondary actors that those precedents establish.

Amici have an interest in the outcome of this case because, if petitioner's theory of primary liability is accepted and § 10(b) private liability is extended to any secondary actor who participates in a transaction with an issuer that is alleged to have the "purpose and effect" of creating a "false appearance of material fact" in furtherance of a "scheme", the ability of amici, and numerous other lawyers practicing in these areas, to provide legal guidance to their clients based upon certain clear and predictable legal standards will be impaired. Amici accordingly submit this brief discussing this Court's decisions on "deceptive" conduct under § 10(b), and their inconsistency with petitioner's theory of "scheme" liability.

## SUMMARY OF ARGUMENT

Petitioner and its amici urge this Court to expand private liability under § 10(b) to secondary actors who do not themselves commit any deception by making a material misstatement or breaching a duty to disclose, but who allegedly participate in a "scheme" with others, the "purpose and effect" of which is "to create a false appearance of material fact in furtherance of that scheme" by an issuer. (*E.g.*, Br. for Pet'r 15.) This invitation should be rejected.

Petitioner's proposed liability theory flatly contradicts decades of this Court's precedents firmly establishing a clear rule limiting liability under § 10(b) to those persons who themselves actually make a material misstatement (or omission in the face of a duty to disclose) or commit a manipulative trading practice. *See, e.g.*, *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164, 177 (1994) ("As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only

the making of a material misstatement (or omission) or the commission of a manipulative act.").

Indeed, the conspiracy-based theory of "scheme" liability advanced by petitioner is virtually indistinguishable from the aiding-and-abetting liability rejected by this Court in *Central Bank*, and if adopted would effectively nullify that decision. Petitioner's test would allow plaintiffs' lawyers to relabel conduct that was previously deemed aiding and abetting or conspiracy as "primary" participation in a fraudulent "scheme", and would even require a different result on the facts of *Central Bank* itself.

This Court's jurisprudence has consistently upheld a bright-line rule limiting deceptive conduct liability under § 10(b) to actors who actually make material misstatements (or omissions in breach of a duty to disclose)—notwithstanding numerous attempts to expand the statute by members of the plaintiffs' bar and even on occasion the Securities and Exchange Commission. Those precedents should not be lightly discarded. The judgment of the court of appeals should be affirmed.

## ARGUMENT

### I. THIS COURT HAS CONSISTENTLY LIMITED LIABILITY FOR "DECEPTIVE" ACTS UNDER § 10(b) TO THOSE ACTORS (WHETHER THEY BE ISSUERS OR SECONDARY ACTORS) WHO ACTUALLY MAKE A MISSTATEMENT OR VIOLATE A DUTY TO DISCLOSE.

#### A. Prior to *Central Bank*, This Court's Decisions Limited the Types of "Deceptive" Conduct Covered by § 10(b).

As the Eighth Circuit recognized, this Court's precedents have established three principles regarding the scope of § 10(b). *First*, the plain language of the statute

prohibits only "manipulative or deceptive" acts, and private plaintiffs may not bring actions under Rule 10b-5 for conduct not prohibited by the statute. *Second*, the term "manipulative", as used in the securities context, is a term of art referring to trading practices that artificially inflate the price of the traded security. *Third*, and most critically for this case, "deceptive" conduct, within the meaning of § 10(b), requires deception—namely, a misstatement or failure to disclose by one who has a duty to disclose. That is precisely why this Court held unequivocally in *Central Bank* that "the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act". 511 U.S. at 177.

*Central Bank* is firmly grounded in prior decisions demarcating the scope of § 10(b). As early as *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), this Court required a finding of a duty to disclose before imposing § 10(b) liability for deceptive conduct in the absence of an affirmative misrepresentation. That case involved a suit brought by Indian sellers of stock in a corporation formed to manage joint assets derived from tribal holdings. The corporation had designated a local bank as its transfer agent, and two of the bank's managers—Gale and Haslem—aided the Indian shareholders in selling their stock. The Indian sellers alleged that the bank and its two employees violated § 10(b) and Rule 10b-5 by failing to inform them about a resale market (created by Gale and Haslem) that offered higher prices.

The court of appeals concluded that Gale and Haslem were liable under Rule 10b-5 "only in those instances where the employee purchased shares for his own account or for resale . . . at a higher price". 406 U.S. at 149. This Court affirmed the court of appeals' judgment "to the extent that it held that the two employees had violated Rule 10b-5". The Court reasoned that, in those instances, the record revealed that Gale and Haslem made a misstatement of material fact in

violation of subparagraph (b) of Rule 10b-5—"namely, that the prevailing market prices of the . . . shares was the figure at which their purchases were made". *Id.* at 152. But the Court rejected the lower court's conclusion that "there was no violation of the Rule unless the record disclosed evidence of reliance on material fact misrepresentations by Gale and Haslem", finding instead that liability existed under subparagraphs (a) and (c) of the Rule, which were not limited to affirmative misrepresentations but extended also to a "course of business" or "device, scheme, or artifice to defraud". *Id.* at 152-53. Contrary, however, to the suggestions of petitioner and its amici that *Affiliated Ute* endorsed "scheme" liability in "conduct" cases without any misrepresentation or violation of a duty to disclose by the defendant,[3] the Court was explicit in noting that what made the employees' conduct fraudulent within the meaning of the statute and subparagraphs (a) and (c) of the Rule was the fact that Gale and Haslem breached an obligation to disclose:

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[3] (*See* Br. for Pet'r 30 (arguing that *Affiliated Ute* demonstrates "that Section 10(b) and Rule 10b-5 extend beyond misrepresentations and omissions"); Br. for Amicus Regents of Univ. of Cal. 27; Br. for Amicus Cal. State Teachers' Ret. Sys. 11; Br. for Amici L.A. County Employees Ret. Ass'n et al. 16; Br. for Amici Change To Win & CtW Inv. Group 24.) These arguments rely on a statement taken out of context from *Affiliated Ute* that "the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact" but that "[t]he first and third subparagraphs are not so restricted", 406 U.S. at 152-53. The misstatements and omissions proscribed by Rule 10b-5(b) to which the Court was referring are only those of parties who actually speak—that is, those who "make any untrue statement of a material fact or . . . omit to state a material fact necessary in order to make *the statements made* . . . not misleading", 17 C.F.R. § 240.10b-5(b) (emphasis added)—not omissions by those who make no misleading statements but who have a duty to disclose. As discussed in the main text, the Court made clear that, even in an action for participation in a fraudulent "scheme" under Rule 10b-5(a) and (c), liability for deceptive conduct by those who remain silent will not lie absent the breach of a duty to disclose.

> "These defendants' activities . . . disclose, within the very language of one or the other of those subparagraphs, a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud upon the Indian sellers. This is so because the defendants devised a plan and induced the [Indian sellers] to dispose of their shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell. The individual defendants, in a distinct sense, were market makers, not only for their personal purchases . . . but for the other sales their activities produced. This being so, they possessed *the affirmative duty under the Rule to disclose this fact* to the [Indian] sellers."

*Id.* at 153 (emphasis added) (citations omitted); *see also id.* (describing the case as "involving primarily a failure to disclose"). The Court left no doubt that it was this duty to disclose—arising from the special relationship between the parties—that formed the basis for liability. *See id.* at 151-52 ("We would agree that if the two men and the employer bank had functioned merely as a transfer agent, there would have been no duty of disclosure here.").[4] Informing the Court's decision was its recognition that the existence of the defendants' duty to disclose was necessary for the plaintiff sellers to be able to satisfy the reliance requirement of the § 10(b)/Rule 10b-5 private cause of action:

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[4] Indeed, this Court has since observed that *Affiliated Ute* established that "silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) . . . *[b]ut such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction*". *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (emphasis added).

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. *This obligation to disclose* and this withholding of a material fact establish the requisite element of causation in fact."

*Id.* at 153-54 (emphasis added) (citations omitted).

Prior to *Central Bank*, the Court provided similar guidance regarding the reach of § 10(b) in *Santa Fe Industries v. Green*, 430 U.S. 462 (1977), and *Chiarella v. United States*, 445 U.S. 222 (1980). In *Santa Fe*, minority shareholders in a company alleged that the majority shareholder violated Rule 10b-5 in conducting an unfair "short-form merger" transaction that eliminated minority shareholders, although full disclosure was made. The court of appeals reversed the district court's dismissal of the suit, holding that a Rule 10b-5 action could be premised on "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure". *Santa Fe*, 430 U.S. at 470. The court of appeals reasoned:

> "An[] erroneous assumption is that in order to allege a claim under Rule 10b-5 there must be some showing of misrepresentation or lack of disclosure. . . . But only subdivision [(b)] of 10b-5 deals with nondisclosure and misrepresentation. The Rule contains two other subdivisions which state explicitly that fraud other than and in addition to a failure to disclose or truthfully represent is also actionable . . . ."

*Green v. Santa Fe Indus.*, 533 F.2d 1283, 1286-87 (2d Cir. 1976).

This Court reversed. Focusing on the text of the statute, the Court concluded that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception". *Santa Fe*, 430 U.S. at 473. Because "the complaint failed to allege a material misrepresentation or material failure to disclose", the Court found "inapposite the cases relied upon by [the plaintiffs] and the court below, in which the breaches of fiduciary duty held violative of Rule 10b-5 included some element of deception". *Id.* at 474-75. Nor could the alleged conduct be deemed manipulative, as that term "is 'virtually a term of art when used in connection with securities markets'" that "refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity". *Id.* at 476 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)).

In *Chiarella*, the Court similarly considered the scope of liability under § 10(b), this time for trading on inside information. The defendant in that case—the employee of a financial printer that had been engaged to print announcements of corporate takeover bids—used his position to trade in the securities of target companies before the takeover attempts were made public. The trial court instructed the jury that it could convict Chiarella for participating in a "scheme to defraud" in violation of Rule 10b-5(a) and (c) if "he 'did not disclose material non-public information in connection with the purchases of the stock'", reasoning that "a 'scheme to defraud' is a plan to obtain money by trick or deceit and that 'a failure by Chiarella to disclose material, non-public information in connection with his purchase of stock would constitute deceit'". *Chiarella*, 445 U.S. at 236 (quoting the trial court's instructions) (alteration omitted).

This Court reversed Chiarella's conviction, holding that Chiarella's conduct could not be characterized as deception under the statute because he had made no misstatement and he had no duty to disclose:

> "[T]he element required to make silence fraudulent—a duty to disclose—is absent in this case. No duty could arise from [Chiarella's] relationship with the sellers of the target company's securities, for [he] had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence."

*Id.* at 232. The Court refused to "recogniz[e] a general duty between all participants in market transactions to forgo actions based on material, nonpublic information", noting that "[f]ormulation of such a broad duty [would] depart[] radically from the established doctrine that duty arises from a specific relationship between two parties". *Id.* at 233.[5] Observing that "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)", *id.* at 232, the Court admonished: "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak." *Id.* at 234-35.

The Court thus made clear in *Santa Fe* and *Chiarella* that the scope of conduct prohibited by § 10(b) and Rule 10b-5 must be determined by close adherence to the statutory language. Because the statute prohibits only manipulation and deception, only those who actually

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[5] The Court's analysis in *Chiarella* disposes of the suggestions by petitioner's amici that "scheme" liability should be derived from some common law "duty" not to scheme. (*See, e.g.*, Br. for Amicus Regents of Univ. of Cal. 23 n.28; Br. for Amici Arkansas et al. 19-22; Br. for Amici Change To Win & CtW Inv. Group 21-22.)

manipulate—as that term of art is used in the securities context—or deceive—which, in the absence of a misrepresentation, requires a duty to disclose—can be held to violate § 10(b), even in cases premised on violations of Rule 10b-5(a) and (c). The Court applied these principles faithfully in its subsequent cases involving § 10(b). *See Dirks v. SEC*, 463 U.S. 646 (1983) (reversing insider trading conviction of "tippee" on the ground that, in the circumstances of the case, the tippee possessed no duty to disclose); *Schreiber v. Burlington N. Inc.*, 472 U.S. 1, 2, 8 (1985) (holding that "misrepresentation or nondisclosure is a necessary element of a violation of § 14(e) of the Securities Exchange Act", after analogizing to decisions under § 10(b) and concluding that, in light of the "congressional concern with disclosure which is the core of the Act", "[a]ll three species of misconduct, *i.e.*, 'fraudulent, *deceptive*, or manipulative,' listed by Congress are directed at failures to disclose" (emphasis added)).

### B. *Central Bank* Directly Foreclosed the "Scheme" Theory of "Deceptive" Conduct Advanced by Petitioner.

At the same time that this Court was requiring fidelity to the statutory text, lower courts were relying on common law tort principles in imposing various forms of secondary liability—including aiding-and-abetting liability and conspiracy liability—on actors who did not themselves commit deceptive or manipulative acts but who allegedly had a connection with someone who did. Indeed, by the time this Court faced the question directly in *Central Bank*, virtually every court of appeals had permitted private actions for aiding and abetting a violation of § 10(b) and Rule 10b-5. *See Central Bank*, 511 U.S. at 192 n.1 (Stevens, J., dissenting) (collecting cases). Although the standards for such aiding-and-abetting liability varied across the Circuits, most courts required an independent securities violation by another actor, and "substantial assistance" and scienter on the

part of the alleged aider and abettor. *See, e.g., Levine v. Diamanthuset, Inc.*, 950 F.2d 1478, 1483 (9th Cir. 1991); *IIT v. Cornfeld*, 619 F.2d 909, 922 (2d Cir. 1980); *Woodward v. MetroBank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975).[6]

In an influential article repeatedly cited by the Court in *Central Bank*, Professor Fischel noted the apparent inconsistency between this Court's § 10(b) jurisprudence and the imposition of secondary liability by the lower courts, arguing that "the theory of secondary liability [under § 10(b)] is no longer viable in light of recent Supreme Court decisions strictly interpreting the federal securities laws". *See* Daniel R. Fischel, *Secondary Liability Under Section 10(b) of the Securities Act of 1934*, 69 Cal. L. Rev. 80, 82 (1981). Professor Fischel concluded that this Court's precedents established that "defendants can be held liable, if at all, only if they have engaged in a 'manipulative or deceptive practice' prohibited by section 10(b)", and that "in order to fall within this statutory prohibition, a defendant, acting with scienter, must make a material misrepresentation or wrongfully fail to disclose despite a fiduciary duty to do so in connection with the purchase or sale of a security, or engage in a manipulative practice designed to mislead investors by artificially affecting market activity". *Id.* at 102-03.

That thesis was validated in *Central Bank*. The facts of *Central Bank* are now familiar: Purchasers of bonds issued by the Colorado Springs–Stetson Hills Public Building Authority filed suit under § 10(b) after the Authority defaulted on the bonds. The purchasers named, among

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[6] Similarly, when Congress responded to *Central Bank* in 1995 by expressly authorizing the SEC to bring actions for aiding and abetting (while specifically declining to permit such actions by private plaintiffs), it defined aiding and abetting as "knowingly provid[ing] substantial assistance" to a primary violator. 15 U.S.C. § 78t(e).

others, the Authority, the underwriters, and the Central Bank of Denver, which had served as indenture trustee for the issuance. The Tenth Circuit concluded that Central Bank could be held liable under § 10(b) for aiding and abetting the fraud by agreeing with certain other defendants to delay an independent appraisal of land that was established as the security for the bonds, despite having learned that an earlier appraisal on which the purchasers were relying was outdated and possibly inaccurate. *Central Bank*, 511 U.S. at 167-69.

In addressing whether such a claim for aiding and abetting was cognizable under § 10(b), the Court began by reviewing its precedents, observing that "our cases considering the scope of conduct prohibited by § 10(b) in private suits have emphasized adherence to the statutory language" and have "refused to allow 10b-5 challenges to conduct not prohibited by the text of the statute". *Id.* at 173. Turning to the language of § 10(b), the Court "reach[ed] the uncontroversial conclusion, accepted even by those courts recognizing a § 10(b) aiding-and-abetting cause of action, that the text of the 1934 Act does not itself reach those who aid and abet a § 10(b) violation". *Id.* at 177. Unlike those courts, however, the Court announced that "that conclusion resolves the case", observing that "[i]t is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text". *Id.* Synthesizing its prior decisions, the Court stated:

> "As in earlier cases considering conduct prohibited by § 10(b), we again conclude that the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act. The proscription does not include giving aid to a person who commits a manipulative or deceptive act."

*Id.* (citations omitted).

As in the *Affiliated Ute* decision, the Court noted that its conclusion was particularly supported in the context of a private civil suit under the § 10(b) implied cause of action because permitting aiding-and-abetting liability "would impose . . . liability when at least one element critical for recovery under 10b-5 is absent: reliance". *Id.* at 180. Because "[a] plaintiff must show reliance on the defendant's misstatement or omission to recover under 10b-5", permitting aiding-and-abetting liability would impermissibly allow a plaintiff to recover "without any showing that the plaintiff relied upon the aider and abettor's statements or actions" and would consequently "disregard the careful limits on 10b-5 recovery mandated by our earlier cases". *Id.*

*Central Bank* thus reaffirmed without any ambiguity that liability under § 10(b) is limited to those who *themselves* actually make a material misstatement or violate a duty to disclose, or who employ a manipulative device as that term of art has been interpreted. Indeed, as the dissent recognized, the majority's rationale "at the very least casts serious doubt" on *all* forms of secondary liability under § 10(b). *Id.* at 200 (Stevens, J., dissenting).[7] The elimination of secondary liability "does not mean", however, "that secondary actors in the securities markets are always free from liability under the securities Acts". *Id.* at 191. On the contrary, the Court made clear that

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[7] *See, e.g., Dinsmore v. Squadron, Ellenoff, Plesent, Sheinfeld & Sorkin*, 135 F.3d 837, 842 (2d Cir. 1998) ("[I]mplying a cause of action for conspiracy would be 'inconsistent with settled methodology in § 10(b) cases' for precisely the same reason that the Supreme Court refused to imply a cause of action for aiding and abetting in *Central Bank*—it would 'extend liability beyond the scope of conduct prohibited by the statutory text.'" (quoting *Central Bank*, 511 U.S. at 177)); *accord Glaser v. Enzo Biochem, Inc.*, 126 Fed. Appx. 593, 599 (4th Cir. 2005); *In re GlenFed, Inc. Sec. Litig.*, 60 F.3d 591, 592 (9th Cir. 1995).

> "Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met. See Fischel, 69 Calif. L. Rev., at 107-108."

*Id.* at 191 (emphasis in original). The Court's citation to Professor Fischel's article confirms that the sort of liability-producing conduct by a secondary actor that the Court had in mind, assuming all of the requirements for primary liability are met, was "the dissemination or transmission of materially inaccurate information to investors" by the secondary actor itself, such as "an accountant's act of certif[ying]" misleading financial statements or an attorney's "prepar[ation of] false opinion letters". Fischel, *supra*, at 107-08. Such a misstatement (or an omission, where there is a duty to disclose) by the secondary actor allows the plaintiff to prove reliance *on that defendant's* actions, an essential requirement of the Rule 10b-5 cause of action.

Petitioner's proposed test—which would impose liability on any person "if the purpose and effect of his conduct is to create a false appearance of material fact in furtherance of" "a scheme to defraud" (Br. for Pet'r 15)—thus cannot be reconciled with this Court's jurisprudence, as the court below correctly recognized. By extending liability to cases where the secondary actor defendant itself does not make a misstatement to investors and does not breach a duty to disclose (or engage in "manipulative" trading practices), petitioner's test lacks any grounding in the text of § 10(b). As in *Central Bank*, "that conclusion resolves the case", for "[i]t is inconsistent with settled methodology in § 10(b) cases to extend liability beyond the scope of conduct prohibited by the statutory text". 511 U.S. at 177.

### C. Petitioner's Theory of "Scheme" Liability Would Nullify *Central Bank*.

In addition to being unmoored from the language of the statute and, consequently, inconsistent with this Court's § 10(b) jurisprudence, petitioner's "scheme" theory of liability would effectively render *Central Bank* a nullity. Under petitioner's reasoning, "giving aid to a person who commits a manipulative or deceptive act", the precise conduct held to be outside the scope of § 10(b) in *Central Bank*, 511 U.S. at 177, would constitute a primary violation if done with the "purpose" to deceive. Thus, the exact conduct that was previously denominated as aiding and abetting—providing "substantial assistance", with scienter, to a primary violator—could in essentially every case be relabeled through artful pleading as "purposeful" participation in a "scheme to defraud".[8] For all practical purposes, *Central Bank* would be rendered a historical relic.

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[8] Claims against transaction counterparties like those against respondents here were pursued prior to *Central Bank* on the precise theory that participation in deceptive transactions constituted aiding and abetting. *See, e.g., K&S P'ship v. Cont'l Bank, N.A.*, 952 F.2d 971, 976 (8th Cir. 1991) (involving aiding-and-abetting claim against banks for making loans that enabled primary actors to "engage in a 'pyramid' scheme"); *Feldman v. Pioneer Petroleum, Inc.*, 813 F.2d 296, 301 (10th Cir. 1987) ("Plaintiffs also alleged that Fidelity Bank . . . aided and abetted in a conspiracy to promote the scheme by engaging in a fraudulent and deceptive transaction to create the false appearance to prospective investors that the Bradford Partnerships could and would obtain the COPP loans from Fidelity Bank."). Given petitioner's broad and subjective test for "scheme" liability, it appears that the only conduct that would be shielded from its reach would be that which would not even have constituted aiding and abetting before *Central Bank*, *i.e.*, non-intentional conduct. *See, e.g., Schatz v. Rosenberg*, 943 F.2d 485, 497 (4th Cir. 1991) (dismissing an aiding-and-abetting claim because "plaintiffs never allege[d] any facts tending to show an intent on [the law firm's] part to violate the securities laws").

Indeed, petitioner's theory would require a different result on the facts of *Central Bank* itself. As noted above, Central Bank was charged with "agree[ing] to delay" a new, independent appraisal of the collateral for a bond issuance for which it was serving as the indenture trustee, despite knowing of possible problems with the existing appraisal that the purchasers were using to evaluate the investment. *Central Bank*, 511 U.S. at 167-68. Central Bank's agreement with the issuer, which enabled it to issue otherwise unmarketable bonds, could easily be relabeled as conduct with the "purpose and effect" of deceiving investors in furtherance of a fraudulent "scheme". In fact, as the court of appeals in *Central Bank* noted, the plaintiffs in that case *did* "allege that the . . . bonds were sold as part of a fraudulent scheme". *First Interstate Bank of Denver v. Pring*, 969 F.2d 891, 895 (10th Cir. 1992); *see also In re Parmalat Sec. Litig.*, 414 F. Supp. 2d 428, 434-35 (S.D.N.Y. 2006) (allowing "scheme" claim for bank's knowing use of outdated valuation). This Court rejected liability nonetheless.

In an effort to distinguish the case, petitioner and its amici attempt to diminish the role of Central Bank in furthering the fraud in that case (*see, e.g.*, Br. for Pet'r 26), with some going so far as to claim that "the allegation against Central Bank was based on a failure to act, rather than on any active conduct" (Br. for Amici Cox et al. 9; *see also* Br. for Amici Adams & von Glahn 12-14), but these arguments ignore the actual record in that case. The court of appeals, for example, observed that the plaintiffs' claim against Central Bank was for violating the statute by "*affirmative action*, specifically by affirmatively agreeing to delay the independent review of the Hastings appraisal". *First Interstate Bank*, 969 F.2d at 902 (emphasis in original). The purchasers similarly asserted in their brief to this Court that the bank "provided critical assistance to the fraudulent scheme by taking affirmative steps to ensure that the shortage of collateral and the defects of the appraisal would be hidden

from plaintiffs and other potential purchasers". Brief for Respondents at 2, *Central Bank*, 511 U.S. 164 (No. 92-854), 1993 WL 13006274; *see also* Brief for Amicus SEC at 19 n.18, *Central Bank*, 511 U.S. 164 (No. 92-854), 1993 WL 13006275 ("[Central Bank's] retraction of its demand for an independent appraisal is unlike conduct that the courts have held to consist of mere silence and inaction.").

Apparently recognizing the inconsistency between their theory of "scheme" liability and this Court's decision in *Central Bank*, petitioner and its amici go to great lengths to trivialize the decision's import, characterizing its reasoning as "dicta" (Br. for Pet'r 28), describing its holdings as "*quite narrow*" (Br. for Amicus Regents of Univ. of Cal. 28-29), and even implying that it was wrongly decided and should be limited to its facts (Br. for Amici Adams & von Glahn 2). They argue that "*Central Bank* clearly—but merely—stands for the proposition that no aiding-and-abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain 'aiding and abetting' language". (Br. for Amicus Regents of Univ. of Cal. 28.) But *Central Bank* was not merely about whether the words "aiding and abetting" appeared in § 10(b). Rather, the Court carefully examined its own precedents to determine the scope of conduct prohibited by § 10(b), concluding that private 10b-5 liability does not reach those who do not themselves commit deceptive acts on which the plaintiff has relied. *See Central Bank*, 511 U.S. at 177 ("As in earlier cases considering *conduct prohibited by § 10(b)*, we again conclude that *the statute prohibits only* the making of a material misstatement (or omission) or the commission of a manipulative act." (emphasis added)). If *Central Bank* is to have any meaning at all, this holding cannot be limited merely to prohibiting claims expressly denominated as "aiding and abetting" while allowing exactly the same allegations to be relabeled as conduct in furtherance of a "scheme". Nor can this holding regarding the *conduct* prohibited by § 10(b) be circumvented by focusing solely on

a defendant's "purpose" and "effects". Similarly, the necessary "showing that the plaintiff relied upon the aider and abettor's statements or actions" that *Central Bank* found to be lacking, 511 U.S. at 180, cannot now be ignored simply by redesignating the same conduct by the same defendants as conduct in furtherance of a "scheme".

The arguments now advanced by petitioner and its amici in support of "scheme" liability are indeed the very arguments advanced in support of aiding-and-abetting liability and rejected by the Court in *Central Bank*. The purchasers in *Central Bank*, for instance, seized on the "any person" and "indirectly" language of § 10(b)—like petitioner and its amici do here—to argue that § 10(b) should be applied "to a broad class of defendants". Brief for Respondents at 15, *Central Bank* 511 U.S. 164 (No. 92-854), 1993 WL 13006274; *see also* Brief for Amicus SEC at 8-9, *Central Bank*, 511 U.S. 164 (No. 92-854), 1993 WL 13006275. This Court, of course, rejected that argument, holding that a defendant must *itself* commit a deceptive or manipulative act to violate § 10(b), 511 U.S. at 175-76, and that the plaintiff "must show reliance on *the defendant's* misstatement or omission", *id.* at 180 (emphasis added).

The arguments advanced by the National Association of Securities and Commercial Law Attorneys ("NASCAT") (essentially, the plaintiff class action securities lawyers) in *Central Bank* further underscore the virtual identity between the "scheme" liability theory petitioner urges here and the aiding-and-abetting liability rejected in *Central Bank*. As amicus in support of the purchasers, NASCAT argued that because "[t]o knowingly render substantial assistance to a fraudulent course of conduct is, in essence, to participate in it", "[a]ll members of such a scheme are responsible". Brief for Amicus NASCAT at 4 (internal quotation marks omitted), *Central Bank*, 511 U.S. 164 (No. 92-854), 1993 WL 13006273. NASCAT further contended that the statute and rule went "far beyond imposing liability for

individual misrepresentations or omissions" and imposed liability for "knowingly participat[ing] in such a fraudulent practice or course of conduct". *Id.* *Central Bank* rejected these arguments as well, making clear that the statute's proscription of deceptive conduct "prohibits only the making of a material misstatement (or omission)". 511 U.S. at 177.

For these reasons, virtually every Circuit to address theories of liability like petitioner's, including the court below, has ruled that a secondary actor that neither makes a misstatement (or omission in the face of a duty to disclose) nor employs a manipulative device may not be held liable in a private action under § 10(b), even if it is alleged to have participated in some manner in a "conspiracy" or "scheme" to defraud. *See Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998) ("[I]f *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting . . . ." (internal quotation marks omitted)); *Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 388 (5th Cir. 2007) ("'[D]eceptive' conduct involves either a misstatement or a failure to disclose by one who has a duty to disclose." (internal quotation marks omitted)), *petition for cert. filed sub nom. Regents of Univ. of Cal. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 75 U.S.L.W. 3557 (U.S. Apr. 5, 2007) (No. 06-1341); *Fidel v. Farley*, 392 F.3d 220, 235 (6th Cir. 2004) ("[H]olding Ernst & Young liable for either its alleged implicit endorsement of the unaudited financial figures or for its failure to insist on a correction to these figures would effectively revive aider and abettor liability in contravention of the Supreme Court's holding in [*Central Bank*]. In *Central Bank*, the Supreme Court held that Section 10(b) 'prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.'"); *In re Charter Commc'ns, Inc., Sec. Litig.*, 443 F.3d 987, 992

(8th Cir. 2006) ("[A]ny defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5."); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996) ("[W]e conclude that in order for accountants to 'use or employ' a 'deception' actionable under the antifraud law, they must themselves make a false or misleading statement (or omission) that they know or should know will reach potential investors."); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) ("In order for a secondary actor, such as a law firm or accounting firm, to be primarily liable under § 10(b), the Plaintiffs must show reliance on the defendant's misstatement or omission to recover under 10b-5." (internal quotation marks omitted)). Only the Ninth Circuit, in adopting a version of the standard that petitioner now urges this Court to endorse, has deviated from this otherwise unbroken line of appellate authority. *See Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1048 (9th Cir. 2006), *petition for cert. filed sub nom. Avis Budget Group, Inc. v. Cal. State Teachers' Ret. Sys.*, 75 U.S.L.W. 3236 (U.S. Oct. 19, 2006) (No. 06-560).

### D. Since *Central Bank*, This Court Has Continued To Require a Misrepresentation or Breach of a Duty To Disclose by the Defendant Before Imposing § 10(b) Liability for "Deceptive" Conduct.

Contrary to petitioner's contentions that *Central Bank*'s holdings have been undermined by subsequent decisions, this Court has continued to require a misrepresentation or breach of a duty to disclose by the defendant itself before finding liability for "deceptive" conduct under § 10(b). For example, in *United States v. O'Hagan*, 521 U.S. 642 (1997)—consistent with *Affiliated Ute*, *Santa Fe*, *Chiarella* and

*Central Bank*—the Court explicitly conditioned liability under the "misappropriation theory" of insider trading[9] on the defendant's breach of his duty to disclose. Thus, the Court explained that "[d]eception through nondisclosure is central to the theory of liability for which the Government seeks recognition":

> "[F]ull disclosure forecloses liability under the misappropriation theory: Because the deception essential to the misappropriation theory involves feigning fidelity to the source of the information, if the fiduciary discloses to the source that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation—although the fiduciary-turned-trader may remain liable under state law for breach of a duty of loyalty."

*Id.* at 654-55. Consequently, "it was O'Hagan's failure to disclose his personal trading to [his client and law firm employer], in breach of his duty to do so, that made his conduct 'deceptive' within the meaning of § 10(b)". *Id.* at 660 (alterations and internal quotation marks omitted).[10]

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[9] "The 'misappropriation theory' holds that a person commits fraud 'in connection with' a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." *O'Hagan*, 521 U.S. at 652.

[10] Petitioner and its amici invoke *O'Hagan*'s statement that § 10(b) liability is not limited to situations where the "purchaser or seller of securities" itself is the subject of the defendant's allegedly deceptive conduct, 521 U.S. at 651, 664, arguing that *O'Hagan* undermines *Central Bank*'s holding that a secondary actor may be held liable under Rule 10b-5 only if it "employs a manipulative device or makes a material misstatement (or omission) *on which a purchaser or seller of securities relies*", 511 U.S. at 191 (emphasis added). (*See* Br. for Pet'r 27; Br. for

Amicus Regents of the University of California asserts (Br. 23) that the duty to disclose required by *Chiarella* and *O'Hagan* applies only to claims based on "a failure to speak" and not to claims based on "conduct". No such distinction appears in those cases. Both cases clearly involved conduct—trading in the market on inside information and misappropriating confidential information for personal gain, respectively—and indeed the conviction in *Chiarella* (reversed by this Court) was explicitly premised on participation in a "scheme to defraud" or "conduct . . . operating as a fraud" in violation of Rule 10b-5(a) and (c), *see* 445 U.S. at 236. *Affiliated Ute*, another case requiring a duty to disclose, likewise involved a fraudulent "course of business" or "device, scheme, or artifice" in violation of Rule 10b-5(a) or (c). *See* 406 U.S. at 153. All of these cases establish that, in the absence of a misstatement by the defendant, the relevant conduct that makes an "act", "artifice", "course of business", "contrivance", "device", "practice" or "scheme"—whatever label the plaintiff decides to pursue—"deceptive" within the meaning of § 10(b) must involve the breach by the defendant of its duty to disclose.

*The Wharf (Holdings) Ltd. v. United International Holdings, Inc.*, 532 U.S. 588 (2001), similarly confirms the necessity of a misrepresentation or breach of a duty to disclose by the defendant for a finding of deceptive conduct. *Wharf* presented the question whether selling an option to

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Amici N.Y. State Teachers' Ret. Sys. et al. 20.) But while *O'Hagan*'s observation is correct in the context of the criminal prosecution involved in that case, it has no application to a private suit under the § 10(b) implied cause of action, for which this Court has imposed additional requirements—including that the plaintiff establish reliance on the defendant's conduct. The *O'Hagan* Court expressly recognized as much. *See* 521 U.S. at 664 ("*Central Bank*'s discussion concerned only private civil litigation under § 10(b) and Rule 10b-5, not criminal liability. *Central Bank*'s reference to purchasers or sellers of securities must be read in light of a longstanding limitation on private § 10(b) suits.").

buy stock while secretly intending never to honor the option constitutes conduct violating § 10(b). 532 U.S. at 589-90. Although the Court could have simply characterized this conduct as a fraudulent "scheme" or "practice", it instead based its finding of liability on the fact that the seller's "secret reservation was . . . a misrepresentation":

> "To sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith. Cf., *e.g.*, Restatement (Second) of Torts § 530, Comment *c* (1976) ('Since a promise necessarily carries with it the implied assertion of an intention to perform[,] it follows that a promise made without such an intention is fraudulent')."

*Id.* at 596 (alteration in original).[11]

Most recently, *SEC v. Zandford*, 535 U.S. 813 (2002), in which a stockbroker secretly sold his clients' securities in order to steal the proceeds, explicitly premised § 10(b)

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[11] Petitioner and various amici assert that the Eighth Circuit's decision is inconsistent with the Court's reference in *Wharf* to "a misrepresentation (or other conduct forbidden by the Rule)", 532 U.S. at 594, as well as with the Court's statement that a Rule 10b-5 plaintiff "must show that the defendant used . . . one of the four kinds of manipulative or deceptive devices to which the Rule refers", *id.* at 593 (setting forth the text of the Rule with subparagraph (b) divided into two parts). (*See* Br. for Pet'r 30-31; Br. for Amicus Am. Ass'n for Justice 8-9; Br. for Amici N.Y. State Teachers' Ret. Sys. et al. 21.) As with the invocation of similar statements in *Affiliated Ute*, these arguments miss the point. *See supra* note 3. The Eighth Circuit appreciated that § 10(b) and Rule 10b-5 reach conduct beyond misrepresentations (and omissions that make statements already made misleading) covered by Rule 10b-5(b); it correctly noted that this Court's precedents also prohibit manipulative trading practices and omissions by those who remain silent but have a duty to disclose. *See Charter*, 443 F.3d at 990.

liability on the broker's breach of his fiduciary duty to disclose. Thus, although petitioner is correct (Br. 31) that this Court stated that "each time [the broker] exercised his power of disposition for his own benefit, that conduct, without more, was a fraud", 533 U.S. at 821 (internal quotation marks omitted), the Court made clear that "each [sale] was deceptive because it was neither authorized by, nor disclosed to, the [clients]", *id.* at 820-21. The Court explained:

> "[A]ny distinction between omissions and misrepresentations is illusory in the context of a broker who has a fiduciary duty to her clients. See *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (noting that 'silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b)' when there is 'a duty to disclose arising from a relationship of trust and confidence between parties to a transaction'); *Affiliated Ute Citizens of Utah v. United States*, 406 U.S., at 153."

*Id.* at 823. Thus, the assertions of petitioner's amici that *Zandford* "confirms that liability can apply even in the absence of a material misstatement" (Br. for Amicus Cal. State Teachers' Ret. Sys. 9; *see also* Br. for Amici Change To Win & CtW Inv. Group 27; Br. for Amici N.Y. State Teachers' Ret. Sys. et al. 22; Br. for Amici Cox et al. 7) are beside the point. The decision below recognized—consistent with *Zandford*—that "deceptive" act liability may be premised on "a failure to disclose by one who has a duty to disclose", *Charter*, 443 F.3d at 990. The critical issue under *Zandford* was whether the defendant *either* made a misrepresentation *or* breached his fiduciary duty to speak; where—as in the present case—there is neither a misrepresentation by the secondary actor nor a breach by that actor of a fiduciary duty to disclose (or "manipulative"

trading practices), then this Court's precedents consistently lead to the conclusion that there is no § 10(b) liability.[12]

### E. *Bankers Life* and *Herman & MacLean* Do Not Upset the Requirement that the Defendant Itself Make a Misstatement or Breach Its Duty To Disclose.

In addition to mischaracterizing several of the cases discussed above, petitioner and its amici mistakenly argue that isolated language from two early decisions—not addressing the meaning of "deceptive" conduct—somehow undermines this Court's subsequent interpretation of that term.

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[12] The suggestions of petitioner and its amici that *Zandford* expanded liability for deceptive conduct beyond misrepresentations and violations of a duty to disclose are belied by the fact that the question that was actually decided by the court of appeals, presented by the petition for certiorari and addressed by this Court was not whether the broker's conduct was "deceptive" under § 10(b)—which was undisputed—but only "whether the alleged fraudulent conduct was 'in connection with the purchase or sale of any security' within the meaning of the statute and the Rule". *Zandford*, 535 U.S. at 815; *see also SEC v. Zandford*, 238 F.3d 559, 564 (4th Cir. 2001) ("The precise issue before us is whether Zandford's alleged fraud is sufficiently connected to a securities transaction . . . ."); Petition for Writ of Certiorari at I, *Zandford*, 535 U.S. 813 (No. 01-147), 2001 WL 34092101 (stating question presented as "[w]hether a stockbroker's fraud is 'in connection with the . . . sale' of securities under [§ 10(b) and Rule 10b-5], when the stockbroker sells his customer's securities for his own benefit and uses the proceeds for himself, without disclosure to his customer and without authorization to do so" (ellipsis in original)); Brief for Respondent at 1, *Zandford*, 535 U.S. 813 (No. 01-147), 2002 WL 405094 ("The parties agree that the outcome turns on the proper interpretation of § 10(b)'s requirement that a deception be 'in connection with' a securities transaction."). In any event, as discussed in the main text, to the extent it discussed the fraud, the Court made clear that it was the broker's breach of his fiduciary duty that made his conduct deceptive.

For instance, petitioner and its amici misread isolated statements from the Court's early decision in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), as supporting their theory of "scheme" liability. (*See, e.g.*, Br. for Pet'r 30.) Although several securities transactions were involved in that case, the only transaction before the Court was one in which an officer of an insurance company and others caused the company to sell almost five million dollars of U.S. Treasury bonds and then misappropriated the proceeds. *See* 404 U.S. at 13 n.10. Despite allegations that "a majority of the board of directors of [the company] was deceived by misrepresentations of other members of the board and some of the defendants that the sale of the bonds was intended only to effectuate a substitution of those assets for a certificate of deposit equal in value", the Second Circuit dismissed § 10(b) claims brought by the company's liquidator because there was no claim that "the full and fair market price was not paid for those bonds by their purchaser" and consequently the alleged "deception did not infect the subsequent sales transaction". *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 430 F.2d 355, 360 (2d Cir. 1970).

The question before this Court was not whether the defendants' conduct was "deceptive" within the meaning of the statute—there was no dispute that the insurance company was "allegedly deceived into authorizing th[e] sale by the misrepresentation that the proceeds would be exchanged for a certificate of deposit of equal value", *Bankers Life*, 404 U.S. at 8 n.1—but only whether that deception was covered by § 10(b) even though "the full market price was paid for those bonds". *Id.* at 9. Concluding that § 10(b) "is not", as the Second Circuit had held, "limited to preserving the integrity of the securities markets" but instead reaches all deceptive conduct "in connection with" the "sale" of a security , *id.* at 12 (internal quotation marks omitted), the Court held that § 10(b) encompassed the defendants' misrepresentation, by

which "the seller was duped into believing that it, the seller, would receive the proceeds", *id.* at 9. The Court expressly declined to consider the potential liability of secondary actor defendant Bankers Life. *Id.* at 13. This early case involving affirmative misstatements by defendants actually relied upon by the plaintiffs is not inconsistent with and does not detract from the Court's subsequent decisions interpreting deceptive conduct to require a misstatement or breach of a duty to disclose. Indeed, this Court has noted that *Bankers Life* is "inapposite" to cases where "there [is] no 'omission' or 'misstatement'". *Santa Fe*, 430 U.S. at 474-75 & n.15.

Nor does *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), assist petitioner. That case held simply that purchasers of registered securities could maintain a § 10(b) action against an accounting firm that had issued an opinion concerning financial statements contained in the registration statement and prospectus, "notwithstanding the express remedy for misstatements and omissions in registration statements provide by § 11 of the Securities Act of 1933". *Id.* at 377. Petitioner and its amici invoke a statement in a footnote in which the Court noted that if "purchasers in registered offerings were required to rely solely on § 11, they would have no recourse against [individuals who play a part in preparing the registration statement but who cannot be reached by § 11] even if the excluded parties engaged in fraudulent conduct while participating in the registration statement", *id.* at 386 n.22. (*See* Br. for Pet'r 30; Br. for Amici Arkansas et al. 26-27; Br. for Amici Cox et al. 7; Br. for Amicus N. Am. Sec. Adm'rs Ass'n 13-14.) Because the secondary actor defendant there had made actual misrepresentations upon which the plaintiffs could rely—conduct that is unquestionably deceptive—the Court had no occasion in this pre-*Central Bank* case to expound further on the scope of "fraudulent conduct" under § 10(b).

Thus, neither *Bankers Life* nor *Herman & MacLean* is inconsistent with the long line of precedents, discussed

above, upon which the Eighth Circuit properly relied in affirming the dismissal of § 10(b) claims against the secondary actor defendants in the absence of any misrepresentations by those defendants and of any fiduciary duty to disclose by those defendants.

## II. PETITIONER'S VAGUE "SCHEME" LIABILITY THEORY WILL HINDER THE ABILITY OF LAWYERS TO REPRESENT CLIENTS WHO DO BUSINESS WITH ISSUERS.

This Court has repeatedly recognized that the legal standard for private liability under the securities laws is "'an area that demands certainty and predictability'"; "'a shifting and highly fact-oriented disposition of the issue of who may [be liable for] a damages claim for violation of Rule 10b-5' is not a 'satisfactory basis for a rule of liability imposed on the conduct of business transactions'". *Central Bank*, 511 U.S. at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988), and *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975)) (alteration in original). Vague tests for liability under § 10(b) "lead[] to the undesirable result of decisions 'made on an ad hoc basis, offering little predictive value' to those who provide services in the securities business", and consequently force defendants "to abandon substantial defenses and to pay settlements in order to avoid the expense and risk of going to trial". *Id.* at 188-89 (quoting *Pinter*, 486 U.S. at 652); *see also Credit Suisse Sec. (USA) LLC v. Billing*, 127 S. Ct. 2383, 2394-97 (2007) (discussing the disadvantages of rules creating "complex, sinuous line[s] separating securities-permitted from securities-forbidden conduct").

The Court's decisions interpreting § 10(b)'s prohibition of "deceptive" conduct have heeded these concerns, establishing a clear rule as discussed above confining private liability to those situations where the defendant itself has made a material misstatement or breached its duty to disclose

to the plaintiff. Petitioner's vague theory of "scheme" liability, by contrast, would expose companies who do business with issuers to § 10(b) litigation whenever a plaintiff can plausibly allege that the counterparty's conduct had the "purpose and effect" of furthering the issuer's "fraudulent scheme". Such "scheme" allegations—always made in hindsight, after something bad has happened at the issuer—may be too readily made, particularly in a business environment in which transactions are frequently complicated and the applicable accounting principles are continuously evolving and require numerous judgment calls.

Such a vague standard of liability will impose particular burdens on transactional lawyers who, like amici, represent an issuer's counterparties. If petitioner's standard of liability is adopted, counterparties and their lawyers could be called upon to determine if the issuer—not the secondary actor client—intends to or could conceivably use the transaction to create a "false appearance of material fact". That determination would add a substantial burden to those lawyers and their counterparty clients, potentially requiring them not only to delve into the business affairs of the issuer, but also to review the work of the issuer's own advisors, including its accountants and lawyers. Such review could require expertise that transactional lawyers usually do not have, including expertise necessary to determine independently the proper accounting treatment for a complex, "cutting edge" transaction.

This is not a situation in which the counterparty client itself is making a statement (which counsel can review), or has a duty to disclose (on which counsel can advise). The counterparty client normally is not involved whatsoever in preparing or commenting upon the (audited) financial statements that constitute the alleged misstatement of the issuer. Rather, the counterparty client is engaged in a commercial transaction with the issuer; the issuer and *its* advisors (*its* lawyers and accountants) will ultimately

determine what the issuer should disclose regarding the transaction. The broad "scheme" liability theory advanced by petitioner potentially could force counsel for the counterparty client somehow to insert himself or herself into the issuer's disclosure discussions and decisions, or leave the counterparty client exposed to potential litigation for a decision by the issuer that the counterparty client ultimately had no ability to control.

There is no question that a vague, expansive theory of private liability for secondary actors places substantial burdens on the ability of counsel to advise their clients on prospective complex transactions, and could lead both to substantially higher transaction costs for clients and issuers and to a natural reluctance to proceed with financing transactions with new or potentially financially troubled issuers. A clear and predictable rule for liability of secondary actors, which amici believe is already found in this Court's precedents, places the burdens where they belong—on each actor and its own advisors—and is the most efficient means of ensuring a fair and open securities market.

## CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

August 15, 2007

Respectfully submitted,

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## Appendix

Amici, along with the law firms of which they are members, are as follows:

Richard I. Beattie
Simpson Thacher & Bartlett LLP

Kenneth J. Bialkin
Skadden, Arps, Slate, Meagher & Flom LLP

Arthur Fleischer, Jr.
Fried, Frank, Harris, Shriver & Jacobson LLP

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